Latin America Markets
OTG Latin America Fund “On The Ground”
Latin America Perspective – Second Half 2023

We are going to focus on the sub-group of economies with the highest GDP in the region and where we have most of our investments: Brazil, Mexico, Argentina, Colombia, Chile and Peru.

The outcome of the world`s sharpest monetary tightening cycles to contain inflation led by Latin America countries is showing positive results.

It is expected that Latin America`s major central banks may now be poised to lead the world on interest rate cutting amid clear signs of slowing inflation in some of the countries of the region.

During the first half of 2023, financial conditions in Latin America held quite steady, despite the financial stress episodes witnessed in the US and Swiss banking systems. It is remarkable how the region's financial markets outperformed those of other emerging market economies, the reopening of China when it ended its zero-covid policy, the better economic data in the US, and commodity prices that are still high in historical terms were important factors to achieve this result. However what has remained high is the uncertainty surrounding economic policies and the social and political unrest in the region.

We are going to highlight the main aspects which we believe will continue for the rest of the year and will have a positive impact for the region.

- Good labour market performance with data higher than pre-pandemic figures
- Unemployment rate might continue to decline.
- Commodity prices should continue to benefit countries that export metals and mining.
- Inflation has continued to decline in the main economies, even though, uneven across countries and there was a lag between them, the overall direction is corrective to less inflation going forward.

The main drivers are:

  - The asymmetric fall in food inflation as international prices fall and exchange rates appreciate.
  - Higher tan anticipated wage growth
  - The slower expected pace of domestic demand
  - The recovery in profit margins after the decline seen in previous years

- The financial markets are factoring in the first policy interest rate cuts in countries such as Brazil, Chile and Peru. The rate cuts are likely to be far smaller that the rate hikes and are expected to be gradual.
- The region's financial variables performed better tan those of other emerging economies, expectations of a restrained monetary easing cycle could work in favor of the Latin America currencies the (carry trade) effect could benefit Brazil and Mexico the region's two largest economies.

- In addition to the favorable carry-trade the region has the implicit backing of the IMF (Mexico, Chile, Colombia; Peru and Panama have signed precautionary lending facilities with the IMF) and the conditions of net commodities exporters, whose prices remain above the historical average.

What we expect of the second half of 2023

We have observed mixed results in LATAM markets where the Andean Region (Peru, Chile and Colombia) were the laggards with negative returns mainly because political and social issues and represented a threat to the stability and growth of the domestic and regional economies, whereas Brazil, Mexico and Argentina follow the path of the global recovery.

The investment case in LATAM markets tends to be most compelling when commodity prices are on an upswing or global risk appetite is expanding *(these two factors usually go hand in hand*).

Strong demand for commodities should continue to support growth in the region with export volumes growing in nearly every major Latin America economy.

Depending on the relationship LATAM countries have with more developed countries, some might benefit more than others. For example, a quick recovery in China will help countries such as Peru, Chile and Brazil more than it would for Mexico and Colombia, which rely more on the recovery of the USA.

What we like for 2H23

We like Brazil, Chile and Mexico at the **country** level, and materials, consumer discretionary, real estate and information technology at the **sector** level.

In ***Brazil:*** We believe the local equity market has already discounted a global economic recession for the rest of 2023, and it should continue to benefit from a global reflation trade in 2H23 and 2024. In addition the new fiscal framework proposal presented by the Brazilian Executive opens doors for a potential mini monetary easing cycle for the rest of the year.

In ***Chile:*** Local equities provide an interesting risk reward model vs the rest of the region supported by historically low valuations; in addition, the low level of debt in the sovereign balance sheet provides ample room for pro-cyclical fiscal policy which should push up their economy and earnings.

In ***Mexico*** the country`s risk link to the US and structural manufacturing drivers (near-shoring and the online transition) should benefit from better economic activity in the US in 2024.

In Peru while cautious, we believe the country`s high leverage to commodity prices should benefit from the ongoing re-opening of the Chinese economy

And lower levels of social unrest.

At the sector level we could divide our investment thesis into 3 aspects:

- **Global growth:** We like companies which would benefit from a global relation trade supported by the recovery of the US and China major partners of Latin America countries where materials should be the main beneficiary.

- **Lower interest rates:** As it was mentioned there is a big chance for these countries to start lowering interest rates which will have a stimulative effect on economic activity and can help spur household expenditures. We will also look for companies with long duration assets.

- **Structural growth:** Here technology and specifically information technology could be a very important player for the region, with fast growing companies trading at attractive valuations.

It is going to be a challenging second half of the year but opportunities can be found with discipline. Focusing on companies with strong balance sheets will be more crucial than ever.

We continue to believe our investment strategy, as echoed by our investment approach, allows the Fund to take advantage of these opportunities found in the Region. Patience, diligence and perseverance are often still required.

This opinion article was written in June 2023 by: Mauricio Alvarez of OTG Latin America Fund.